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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

No. [redacted] 5

HARRY H. NEUBERGER,

Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF.

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IN THE

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OCTOBER TERM, 1939.

No. 548.

HARRY H. NEUBERGER,

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—against—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF.

The brief in opposition treats matters of importance in a manner so cavalier as to require a short reply.

I.

Importance of the question of statutory interpretation.

The Government says that the question of statutory interpretation is not important because covered for 1938 and subsequent years by the Revenue Act of 1938.

The year in question is 1932. It is not denied that the question in this case arises for the six tax years 1932 to 1937 inclusive. It is not denied that the question in this case was presented in dozens of cases, some

still pending. It is not denied that the basic issue in the case, whether partnership income retains its identity in the hands of the partner, arises in at least seven different ways, and that cases involving the general problem are now pending and will continue to arise, and that on most of these points the statute is still silent. (See Petition for Certiorari, pp. 7, 8.)

When the Government applies for certiorari on a question covered by a later Revenue Act, it sings a different tune. It is not deterred from claiming that the question is important by reason of the fact that the specific issue has been covered by a later statute.

In *Smith* v. *Higgins,* 102 F. (2d) 456 (C. C. A. 2d), certiorari granted October 9, 1939, and in *Helvering* v. *Johnson,* 104 F. (2d) 140 (C. C. A. 8th), certiorari granted October 9, 1939, the issue was whether an individual realized a deductible loss upon the sale of securities to a corporation controlled by him. The tax year 1932 was involved in both cases. Section 24(a)(6) of the Revenue Act of 1934 provided that such loss was not allowable. Hence, at the time the Government filed the petitions for certiorari in 1939, the question was covered by the Act and could still arise only with respect to tax years earlier than 1933.

This is what the Government said about the 1934 Act in its petition for certiorari in the *Smith* case (p. 19):

> "The 1934 amendment does not demonstrate that the case at bar is unimportant. * * * It may also be noted that this Court has granted a writ of certiorari to resolve a conflict of circuits notwithstanding the repeal of the statute involved and although no similar case was pending or could arise."

The taxpayer strenuously contended that the 1934 amendment made the question academic, but certiorari was granted.

II.

Conflict With the *Coulby* Case.

The Government says that the decision below was not in conflict with the *Coulby* case because the decision in the latter case "was based squarely on the Court's interpretation of the specific provisions of the 1913 Act" (Br. in Opp., p. 5, footnote). This is an amazing statement.

If there was a specific provision in the 1913 Act covering the issue in the *Coulby* case, why does not the Government cite it? There was no such provision. In fact, in the *Coulby* case, the Government argued that since the 1916 Act did contain a specific provision with respect to the deductibility by a partner of his share of the partnership dividend income, the 1913 Act should be construed not to allow such deduction.

The question in the *Coulby* case arose precisely because there was no specific provision in the 1913 Act on the dividend question there at issue. In this respect, the case presented exactly the same problem as this case, and the Court there dealt with the question before it by applying the general rule that partnership income retains its identity in the hands of the partners. This is the rule which petitioner now seeks to have this Court apply here.

In order that the Court may determine whether the *Coulby* case and the decision below are in con-

flict, we print below in parallel columns the basis of decision in the *Coulby* case (251 Fed. at 984) and in the *Johnston* case (86 F. (2d) at 734):

Coulby	*Johnston*
"The law is so framed as to deal with the gains and profits of a partnership as if they were the gains and profits of the individual partner. * * * The law looks through the fiction of a partnership and treats its profits and its earnings as those of the individual taxpayer. Unlike a corporation, a partnership has no legal existence aside from the members who compose it. The Congress, consequently, it would seem, ignored, for taxing purposes, a partnership's existence, *and placed the individual partner's share in its gains and profits on the same footing as if his income had been received directly by him without the intervention of a partnership name.*" (Italics ours.)	"* * * when the partnership return shows net income, a partner's distributive share is to be entered in his own return as his own income derived from the partnership without retaining the peculiar character it had in the partnership return unless Congress has expressly so provided and then only for the purpose stated."

In the *Coulby* case there was no specific provision dealing with the deductibility by a partner of his share of the partnership's dividend income. In this

case, there is no specific provision dealing with the deductibility by a partner of individual security losses against partnership security profits. In both cases, the law provided that partnerships as such paid no tax and that the individual partners reported their shares of the partnership income.

Accordingly, both Courts were compelled to and did approach the question from the point of view of the general nature of partnership income. The Sixth Circuit decided that the partnership income retained its identity in the partners' hands. The Second Circuit decided that the partnership income did not retain its identity in the partners' hands.

III.

Conflict With *Jordan v. Roche*, 228 U. S. 436.

The Government denies this conflict on the ground that, in the *Jordan* case, the legislative history showed that the particular amendment involved was intended as an explicit provision of the purpose of the prior law, and says: "There is no comparable legislative history here and petitioner points to no reason why, under the circumstances of the present case, the usual inference should not be drawn" [that the later statute changes the former] (Br. in Opp., p. 7).

We assert that there is comparable legislative history here and offer the following reasons why, in this case, the later statute shows the intention of the prior:

1. Between 1918, when the *Coulby* case was decided, and 1936, when the *Johnston* case was decided by the Court below, it was uniformly held that part-

nership income retained its identity in the hands of the partner. This was referred to by Judge Swan in his dissenting opinion in the *Johnston* case (86 F. (2d) at 735).

2. There never has been any provision in the Tax Law denying to an individual partner the right to offset his individual security losses against his share of partnership security profits. The first enactment on the subject was §182 of the 1938 Act, which allowed the deduction. This provision was included in the first general Revenue Act after the *Johnston* case in order to make it clear that Congress disapproved that case.

3. In covering the instant point in the 1938 Act, the Ways and Means Committee said that the new provision was "a logical corollary of the principle that only the partners as individuals, not the partnership as an entity, are taxable persons" (see Petition for Certiorari, p. 12). As this corollary was no more logical in 1938 than in 1932, the present situation is clearly one where, as the Courts held in *Jordan* v. *Roche* and in the *Coulby* case, the specific language of the later statute is indicative of the intention of the earlier. In the *Coulby* case such later statute, as in this case, dealt specifically with the nature of partnership income in the partners' hands for tax purposes.

IV.

The Constitutional Question.

The Government states that the constitutional issue has been decided against petitioner in cases in which this Court has denied petitions for certiorari. It cites the *Johnston, Davis* and *Klingenstein* cases.

In the *Johnston* case, the constitutional question was not raised in the Circuit Court of Appeals nor presented by the petition for certiorari. The *Davis* case involved a casual investor, not a trader in securities. In the *Klingenstein* case the constitutional question was not presented to the Court of Claims nor raised in the petition for certiorari in this Court. In none of these cases was the taxpayer engaged in the business of trading in securities, as he is in this case.

There has never been a case which disallowed to a person engaged in business deductions for losses sustained in the conduct of that business. The Government's statement to the contrary is unwarranted and certainly not justified by the cases it cites.

V.

The Commission Question.

The Government says that on this issue there is no conflict with the decision of any other Circuit Court of Appeals (Br. in Opp., p. 7).

The commission issue involves the question whether commissions paid by petitioner to his partnership retained their identity as commissions when repaid to him. In holding in effect that they do not, the decision of the Court below is in conflict with the decision in the *Coulby* case, where partnership income was held to retain its identity in the partners' hands. Further, as to this issue, it is not open to the Government to claim that the question is controlled by a later statute, as there is none on this point.

In any event, petitioner submits that there is nothing in the *Winmill* case to support the arbitrary and unjust result reached below with respect to the portion of the purchase commissions repaid to taxpayer by his partnership.

CONCLUSION.

For the reasons set forth in the petition for certiorari, some of which are restated herein, the petition should be granted.

Respectfully submitted,

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December, 1939.